

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

ECUADOR

**SOCIAL ENTREPRENEURSHIP PROGRAM
SUPPORT MECHANISM FOR RURAL COOPERATIVE
ENTERPRISES**

(SP/TC-0202032-EC)

PROPOSAL FOR TECHNICAL COOPERATION AND FINANCING

This document was prepared by the project team consisting of: Fermín Vivanco, Project Team Leader; Edgar Carvajal (COF/CEC); Leyda Fajardo (LEG/OPR); and Valnora Leister (LEG/OPR).

CONTENTS

EXECUTIVE SUMMARY

I.	FRAME OF REFERENCE.....	1
A.	Poverty and the rural economy of Ecuador	1
B.	Efforts aimed at financing cooperative activities in the rural sector	1
C.	Problems encountered by producer associations in rural areas	3
D.	The Bank's strategy and experience with support programs for microenterprises and small farmers	5
1.	Background to the Social Entrepreneurship Program in Ecuador	5
2.	Strategy and Policy of the Social Entrepreneurship Program	5
3.	Advantages and innovations included in the Support Mechanism for Rural Cooperatives	6
E.	The Bank's role.....	7
F.	Origin of the operation	8
G.	Statement of nonobjection.....	8
II.	THE PROGRAM	8
A.	Objectives.....	8
B.	The program's beneficiaries and strategy for supporting them	9
C.	Components	9
1.	Reimbursable financing	9
2.	Technical cooperation	10
D.	Costs and financing	12
III.	EXECUTING AGENCY AND INTERMEDIARY ENTITIES.....	12
A.	Status, origin and objectives of the executing agency	12
B.	Organizational structure of the executing agency	13
C.	Activities of the executing agency	13
D.	Financial status of the executing agency	14
E.	Comparative advantages of selecting the RFR as executing agency	14
F.	Rural credit entities (RCEs)	15
G.	Justification for the choice of the RFR as executing agency for the reimbursable financing	15
IV.	EXECUTION OF THE PROGRAM.....	16
A.	Responsibility for Program Execution.....	16
B.	Execution and administration of the program	16
1.	Reimbursable financing for subprojects carried out by associations	16
2.	Technical cooperation	17

C.	Execution period and disbursement schedule	18
D.	Monitoring and oversight	19
E.	Reports	19
F.	Performance indicators	20
G.	Evaluations	21
H.	Special contractual conditions	22
V.	FEASIBILITY AND RISKS	23
A.	Institutional feasibility	23
B.	Socioeconomic feasibility	23
C.	Financial feasibility	24
D.	Environmental and social aspects	24
E.	Risks	25
F.	Justification	25

ANNEXES

Annex I	Plan of operations
Annex II	Logical framework

BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

English:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

Spanish:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

ABBREVIATIONS

CFN	Corporación Financiera Nacional
CONAIE	Confederación de las Nacionalidades Indígenas del Ecuador [Confederation of Indigenous Peoples of Ecuador]
FEINE	Federación Ecuatoriana de Indígenas Evangélicos [Ecuadorian Federation of Evangelical Indians]
FENOCIN	Federación Nacional de Organizaciones Campesinas, Indígenas y Negras del Ecuador [National Federation of Indigenous, Black and <i>Campesino</i> Organizations]
FEPP	Fondo Ecuatoriano Populorum Progreso [Popular Progressive Fund of Ecuador]
FONLOCAL	Trust Fund established under a loan from the World Bank, administered by the CFN and with the MBS and IICA as constituents
IICA	Inter-American Institute for Cooperation on Agriculture
MBS	Ministerio de Bienestar Social [Ministry of Social Welfare]
MFI	Microfinance institution
NARE	Nonagricultural rural employment
NGO	Nongovernmental organization
PEU	Project executing unit
PRODEPINE	Proyecto de Desarrollo de los Pueblos Indígenas y Negros del Ecuador [Indigenous and Afro-Ecuadorian People's Development Project]
RCE	Rural credit entity
RFR	Red Financiera Rural [Rural Financial Network]
SEP	Social Entrepreneurship Program
SPP	Small Projects Program

SOCIAL ENTREPRENEURSHIP PROGRAM
SUPPORT MECHANISM FOR RURAL COOPERATIVE ENTERPRISES
(SP/TC-0202032-EC)

EXECUTIVE SUMMARY

Executing agency: Rural Financial Network (RFR)

Amount and Source:	Reimbursable financing:	US\$1,200,000
	Technical cooperation:	US\$ 450,000
	Local counterpart:	<u>US\$ 285,000</u>
	Total:	US\$1,935,000

The resources will be drawn on the net income of the Fund for Special Operations (FSO).

Terms and Conditions of the Financing:	Amortization period:	15 years
	Grace period:	5 years
	Disbursement period:	42 months
	Execution period:	36 months
	Interest rate:	2% annual
	Currency:	US dollars

The grace period will apply only to the amortization of principal, and not to interest. The executing agency will sign loan agreements with intermediary financial institutions, and will establish a loan-loss reserve.

Problem to be addressed: Opportunities for employment in the formal sector of Ecuador's rural economy are increasingly rare. At the same time, the country's indigenous and *campesino* sector has a long tradition of working cooperatively to achieve economies of scale in the purchase of inputs and the production and marketing of farm products.

At various meetings with organizations supporting indigenous groups and the small farming sector, the Bank concluded that there is a need for cooperative projects to improve their management of key areas, including: (i) the sale and marketing of products; (ii) agricultural operations; (iii) administration and finance; and (iv) strategic planning. A large proportion of these organizations receive no support beyond initial training in agricultural areas, and lack commercial feasibility studies on new products, pricing systems, accounting systems and business plans.

In recent years a number of options have emerged for the financing of cooperative enterprises in Ecuador, and seven rural credit intermediaries have been identified to date, including credit unions and nongovernmental organizations that provide loans to their members. However, few of these cooperative enterprises have access to the working capital and fixed assets needed to improve their products.

Therefore, the creation of a program to provide incentives for micro-finance organizations to serve the rural sector more effectively will ensure sustainable financing and advisory services for cooperative enterprises and encourage the development of best practices in the credit technology used by rural associations.

Objectives:

The overall objective of this program is to help improve the socioeconomic conditions of low-income families living in rural Ecuador.

Its specific objectives are to: (i) establish an effective and sustainable mechanism for identification, selection, approval and supervision of preinvestment and investment in cooperative subprojects for production in rural Ecuador; (ii) help at least 50 producer associations to determine the commercial viability and improve the management of their projects; (iii) help 35 rural producer associations increase income and develop initiatives to obtain funding for expansion of their activities; (iv) provide institutional strengthening for participating producer associations so that they eventually gain access to local financing; and (v) achieve the critical mass of subprojects necessary to disseminate lessons learned in Ecuador about the financing and management of rural production activities.

Description:

In order to meet the identified need for both improved management and financing of subprojects for production, a **support mechanism for cooperative enterprises** will be established in Ecuador, under which the Bank will provide Bank's resources through rural credit intermediaries to low-income groups in rural areas.

The program consists of a reimbursable financing component and a nonreimbursable technical-cooperation component, and will have a total budget of US\$1,935,000. The Bank is allocating US\$1,650,000 to the program from the net income of the Fund for Special Operations (FSO). In addition, the participating rural credit intermediaries will provide US\$285,000 as local counterpart funding under the program.

1. Reimbursable financing (Bank: US\$1.2 million; local counterpart: US\$180,000)

This component will finance production activities under subprojects to be carried out by cooperative enterprises using resources provided by participating rural lenders, primarily nongovernmental organizations and credit unions with experience in lending to cooperatives. At least 35 such subprojects will receive financing under this component.

The program will provide the working capital and fixed assets necessary to carry out production, marketing, processing or investment activities under subprojects for cooperative enterprises that are financially sustainable and capable of meeting repayment obligations, are located in rural areas and involve indigenous and *campesino* communities, and that have as their primary aim to improve links between the cooperative or association and its customers.

2. Technical cooperation (Bank: US\$450,000; local counterpart: US\$105,000)

The technical-cooperation component will consist of two subcomponents: the first of which will be executed independently, while the second will be carried out *pari-passu* with activities under the reimbursable financing component.

a) Technical assistance fund for subproject identification (preinvestment)

A total of US\$100,000 in technical-cooperation resources will be used to carry out some 50 preinvestment studies. The purpose of these studies is to assess the financing needs of each subproject. The studies will be carried out by consultants listed in the roster of rural experts.

b) Technical assistance fund for institutional strengthening

Strengthening for the cooperatives. The sum of US\$250,000 will be used to fund 35 technical-cooperation projects for associations

that are successful in obtaining reimbursable financing. Each association may receive up to 20% of the amount of the reimbursable financing granted to the respective subproject. The fund will be used to finance the following technical assistance activities: (i) business advisory services; (ii) technical advisory services on investment and procurement of inputs; (iii) management consulting for the producers association; (iv) assessing execution of the subproject's plan; (v) advice on the establishment of accounting and financial management systems for monitoring of economic performance and access to other sources of financing; (vi) assistance for legal registration and formal establishment of the association; and (vii) technical advisory services to improve quality, sales, productivity and rate of return.

Strengthening for the program. Resources totaling US\$50,000 have been earmarked for program start-up, particularly outreach, drafting of rules and procedures, initial screening of subprojects, and a mid-term evaluation to measure progress under the program and document lessons learned. The program includes allocation of a further US\$50,000 for evaluations, audits, materials and information activities.

**Environmental
and social
review:**

At its meeting on 1 March 2002, the CESI approved the project profile with recommendations that are reflected in the main document. These include the social and environmental requirements to be established and evaluated in subproject analysis, monitoring of environmental aspects and the program in general, as well as technical assistance for the end-beneficiaries in sustainable management of natural resources.

Beneficiaries:

The beneficiaries of the program will be the families of some 2,000 small-scale, low-income farmers in rural indigenous or campesino communities who belong to an association with at least 10 members, such as a cooperative, producer association or other cooperative enterprise. These families have a standard of living that includes several unmet basic needs and an average annual per capita income of around US\$600.

Risks:

The program will establish a system under which 100% of the credit and exchange risk will be transferred to the intermediaries. Accordingly, the main project risk is that the intermediaries may not select the best subprojects. The following measures have been taken to minimize this risk: (i) the intermediaries will have a data base of subprojects that meet the eligibility criteria and have a good record of performance over a period of at least two years; (ii) subprojects applying to the program will have an opportunity to obtain technical-cooperation resources with which to conduct feasibility studies that

will help the intermediaries determine the viability of the investment requested; and (iii) participating intermediaries will be required to have prior experience lending to associations.

A second risk inherent in the program is a possible conflict of interest between the Rural Financial Network and participating intermediaries, if an intermediary that is a member of the Rural Financial Network falls behind in its payments and seeks special treatment from the Network. This risk is being mitigated by the fact that there will be only six or seven participating intermediaries under the program, making up a relatively small proportion of the total membership of the Rural Financial Network. The remaining members (numbering 27 as of July 2002) will wish to maintain the reputation of the Network, and will not permit one member to jeopardize its relationship with the Bank.

**The Bank's
country
strategy:**

This program is consistent with the Bank's country strategy, which includes initiatives in key areas such as support for sustainable regional development and poverty reduction. Within these strategic areas, the Bank has identified a number of priorities including support for Ecuador's efforts to achieve growth in its agricultural sector and expand exports of nontraditional products and handicrafts.

Justification:

The justification of this program lies in its consolidation of a large number of small-scale technical-cooperation projects and subloans to cooperative enterprises into a single operation, reducing the high transactions costs that would be incurred if the Bank had to approve and administer each project and loan individually.

The program is also justified by the fact that it will: (i) support the development of production and marketing projects to be carried out by producers in rural areas; (ii) give low-income rural associations better access to sources of financing and investment in production, processing and value-added projects, which are vital for improving productivity and competitiveness; (iii) establish a sustainable private-sector mechanism to strengthen a large number of rural cooperatives; and (iv) help develop best practices in lending technology for associations.

**Reports and
Evaluations:**

Reports. Within 60 days after the end of each six-month period, beginning in the year of the first disbursement under the program, the Rural Financial Network will submit semiannual progress reports to the Bank containing financial details and a description of activities. The progress reports will include: (i) information on the procedures carried out and the subprojects chosen in the selection process; (ii) a description and financial information on the

subprojects being carried out, in a format previously established with the Bank; (iii) a report on the intermediaries invited to participate in the program and indicating how representative they are of the sector; and (iv) information on the quality of the subloan portfolio. The last of these reports will be the final report on the program and must contain a summary of the results achieved compared with the original objectives.

The Bank will review the results and recommendations set out in these reports. In the event that significant deficiencies are detected in program execution, the Bank will not authorize any further disbursements until the Rural Financial Network has taken the satisfactory measures to correct them. In addition, a financial report drawn up by independent authorities will be submitted within 90 days after the disbursement period for the nonreimbursable technical-cooperation component, indicating how the Bank's contribution was used.

Evaluations. Once 60% of the nonreimbursable financing has been disbursed, the Rural Financial Network will use technical-cooperation resources to hire an outside evaluator to carry out a mid-term evaluation of the program. The appointment of this external evaluator will require a statement of nonobjection from the Bank. Among the main aspects to be analyzed in the mid-term evaluation are: (i) demand for credit resources, as reflected in the proposals received and assessed by the executing agency; (ii) executing agency compliance with the rules and procedures established for the program; (iii) how swiftly the program responded to demand; (iv) the quality of the Rural Financial Network's portfolio of loans to the intermediaries and the quality of intermediary portfolios of subloans to cooperative enterprises; (v) the social impact of the subprojects and their sustainability, as reflected in business development; and (vi) recommendations to both the Bank and the executing agency for improving program administration.

Once 100% of the reimbursable financing has been disbursed, the Bank will also hire independent evaluators to conduct a final evaluation of the program. Among other aspects, this final evaluation will include an analysis of: (i) the results obtained from investments made by associations of small farmers and end users; (ii) the effectiveness and efficiency of the executing agency in managing the Bank's resources; and (iii) the lessons learned from the program that can be applied to other financial facilities of the Social Entrepreneurship Program.

Special contractual conditions:

For the first disbursement of the reimbursable financing, the Rural Financial Network must submit the following to the Bank: (i) the loan agreements between the Rural Financial Network and at least two rural credit intermediaries for a minimum of US\$240,000, containing a clause calling for entry into force on the same date that the Bank makes its disbursement to the Network; (ii) the final Operating Regulations and Credit Regulations, together with evidence that they have entered into force; (iii) the business and investment plan; (iv) evidence that the executing unit has been established; (v) evidence that the rural credit intermediaries applying to participate in the program meet the general eligibility criteria; and (vi) the agreement signed between the Rural Financial Network and an Ecuadorian bank operating in rural areas which will administer the project funds in trust according to the terms and conditions established in the technical files.

Prior to the disbursement that brings the reimbursable financing disbursed to over 20% of the total, the Rural Financial Network will provide the Bank with: (i) evidence that all of the previously disbursed resources have been delivered to the rural credit intermediaries; and (ii) the loan agreements between the Rural Financial Network and rural credit intermediaries for a minimum amount equal to the requested disbursement, and containing the two clauses referred to under condition (i) in the preceding paragraph.

For the first disbursement under the first subcomponent of the technical-cooperation component, the Rural Financial Network will submit to the Bank's satisfaction the updated roster of consultants and experts. And for the first disbursement under the second subcomponent of the technical-cooperation component, the Rural Financial Network will submit a work plan for execution of the technical-cooperation component.

Exceptions to Bank policy:

The proposed program is an umbrella facility, as defined in the Bank's Social Entrepreneurship Policy (GP-75-9). Although according to the policy, the approval process for individual operations under umbrella facilities is to be carried out by the Bank's Country Office, in the proposed project, the Bank is providing a set of selection criteria and allowing the program's executing agency to manage the approval process. This exception is justified by the economy of scale that will be achieved through decentralized management of the operation, and is consistent with the philosophy of the umbrella facility.

I. FRAME OF REFERENCE

A. Poverty and the rural economy of Ecuador

- 1.1 Forty-three percent of Ecuador's people are indigenous and some 51% of its citizens depend on the informal sector and microenterprises. Both figures are significantly higher in rural areas where fully one-third of the country's population continues to live, among the highest non-urban percentages in Latin America. In 1999, the percentage of the rural population living in poverty was 79% in the country's highlands. In these areas, 85% of homes are without running water. At present, people of working age are abandoning the countryside in huge numbers, either moving into the cities or leaving the country. It is estimated that 10-15% of the population has emigrated from Ecuador since 1997, primarily to the United States and Europe.¹
- 1.2 One of the most important factors causing the lack of alternatives for generating income among rural producers is their lack of knowledge concerning customer needs in areas with the greatest potential for growth, namely among urban dwellers and in specific markets such as those of the export sector and agri-food industry. This information-gap means that low-income farmers must sell their products locally on markets that are often already saturated and with minimal value-added.
- 1.3 **The contribution of the agriculture and livestock sector** to the country's economy has fallen over the last two decades but continues to play a significant role in Ecuador's socioeconomic structure. Forty-five percent of the country's economically active population is still employed in agriculture and livestock raising, and related sectors. Ecuador has a number of specialty products that are important in the agro-export and agri-food industries, led by bananas, shrimp production and flower exports, in addition to traditional products such as coffee and cocoa. **Other rural activities** are as important as the agriculture and livestock sector in terms of job creation. Among these activities, the most important are food processing, the transport industry, provision and storage of goods and equipment, agricultural tourism and services.

B. Efforts aimed at financing cooperative activities in the rural sector

- 1.4 In order to **help alleviate rural poverty** and develop new alternatives for income generation, various NGOs and foundations are providing support for the many producer associations that have sprung up among the country's rural population. In this, Ecuador is no exception to the pattern among Latin American countries. According to a study of best practices in nonagricultural rural employment

¹ The Economist Intelligence Unit: Ecuador Country Report (November–December 2001) and Banco Central del Ecuador (December 2001).

(NARE) conducted by the World Bank in 2001,² almost all of the successful initiatives aimed at creating such employment in Latin America were developed by rural economic groupings such as producer associations and cooperatives. In the sample of NARE best practices examined in the study, approximately 60% of the initiatives involved food preparation, some 35% had to do with the manufacture and marketing of other products, and the remaining 15% services such as tourism. These initiatives or **cooperative subprojects**³ were created by small farmers who form cooperatives to develop economies of scale and new synergies in training, procurement of inputs, production, financing and marketing. The results of the study indicate that the key to success in these subprojects is to define specific markets and then direct the group's activities toward fulfilling the requirements of those markets.

- 1.5 **Local private enterprise** has created a number of informal financial intermediation mechanisms in rural areas of Ecuador to supply the necessary funding for cooperative subprojects, including community credit unions, village banks and tandas.⁴ These informal small-scale intermediaries are designed to provide funds for small production or consumer activities and social emergencies, and are underwritten by entities such as Swisscontact and Fondo Ecuatoriano Populorum Progressio (FEPP). There are also a number of **microfinance institutions** (MFIs) operating in rural areas which grant loans for subprojects involving production. But these have only provided limited support to date since the bulk of their resources has been reserved for tradition micro-lending operations. Among microfinance institutions, the most important are the 17 members of the Rural Financial Network (RFR) that provide credit services in rural areas. **Seven of these have already granted loans for cooperative subprojects** but lack the necessary resources to meet demand. It should be noted that these rural MFIs are often the only financial entities with a permanent presence in remote areas, and hence the only lenders in contact with low-income producer associations.
- 1.6 As of December 2001, Ecuadorian FMIs held a total loan portfolio worth approximately US\$110 million and consisting of 225,000 clients, and included a specialized bank (Banco Solidario), one operator associated with the country's largest bank (Banco Pichincha), various SLAs and NGOs, and one finance company (Financiera Ecuatorial).
- 1.7 **Public sector participation** includes the PRODEPINE and PROLOCAL programs which are financed by the World Bank and have begun offering support for

² "Mejores prácticas y estrategias para fomentar la generación de empleo no agrícola en América Latina", World Bank 2001, Julio A. Berdegú et al.

³ These rural production initiatives are hereafter referred to as *cooperative subprojects* in order to avoid confusion with the more formal regional or national NGO initiatives, which will continue to be called *projects*.

⁴ A *tanda* is a rotating savings and credit association into which members make weekly payments, with all funds going to a different member each week on a rotating basis.

decentralized rural projects.⁵ Work has been carried out as well under programs developed by the Ministry of Social Welfare to provide training and agricultural extension services in rural sectors. With the Bank's support, the Ministry of Agriculture is also taking steps to support nontraditional agriculture and livestock activities through the PROMSA or INCCA programs.

- 1.8 Despite these private and public sector initiatives, the majority of producer associations do not have access to support of any kind, beyond initial training on specific agricultural products, and it is difficult to obtain financing for working capital and investments. The Bank has been in contact with NGOs and SLAs in various regions of Ecuador, and has held two workshops attended by the most important entities providing support for indigenous groups living in rural areas, including the Confederation of Indigenous Nationalities of Ecuador (CONAIE), the National Ecuadorian Federation of Indigenous, Black and Campesino Organizations (FENOCIN), and the Ecuadorian Federation of Evangelical Indians (FEINE). Both workshops reported a growing number of rural cooperative subprojects organized by indigenous groups and small-farmer associations, with growth and income-producing potential in areas afflicted with high levels of rural poverty. The technical files contain a list of 26 subprojects relating to production and already identified as having the above characteristics. A handful of the subprojects identified to date are shown below.

Canton or Province	Name of the project	Specific product or activity	Investment estimate US\$	Name de Association receiving support	No. of Members
Cuenca, Azuay	Market access and integration	Leather goods	26,300	Cooperativa Centro de Bordados Cuenca	200
Manta, Manabí	Native Latin American appetizers	Cooperative production and sale of food items	35,600	Asociación de Mujeres por un Futuro Mejor	60
Pastaza, Pastaza	Manufacture of natural soaps and shampoo	Cleaning products	87,000	Org. de la Nacionalidad Zápara (ONZAE)	29
Sigsig, Azuay	Improvement of water and irrigation services	Water supply services	27,000	Sistema de Riego San Ramón	113
Napo, Amazonía	Production of cheeses and exotic fruit yogurts	Production and quality assurance	57,000	Asociación de Queseros del Chaco	25
Sucumbíos, Amazonía	Farming of Tilapia and Cachama	Bulking center	50,000	Shuhusfundi	300

C. Problems encountered by producer associations in rural areas

- 1.9 **Preinvestment needs.** The associations, cooperatives and other associative enterprises which are responsible for subprojects involving agricultural production recognize that they lack the necessary tools for successfully managing their projects.

⁵ It is important to note that both projects have expressed interest in the development of this program and the opportunity for coordination and building upon the experience they have gained in starting up their operations.

- a. It is in the **area of trade that their greatest weaknesses can be seen**. The producer associations have not defined their markets and are thus unaware of their customers' requirements and preferences. For example, they have no information on the health and presentation requirements for selling food products through formal urban outlets such as supermarkets, nor have they attempted to explore alternative channels for distributing their goods. In many cases they have no idea of the commercial feasibility of new services or products. And indigenous subprojects generally lack the background information and tools needed to set market prices that will allow them greater return from their products and services.
 - b. In the **management area**, these subprojects lack a business model for effective operation and the delegation of responsibilities. Thus, even though these initiatives are managed by an association or cooperative, the entity in charge has no knowledge of the best practices for management of associative enterprises in general. As a result, the subprojects may very well fail due to mismanagement, even where the product itself is commercially viable.
 - c. In the **area of administration**, these subprojects rarely employ professional accounting and financial systems that would enable them to keep proper records of their activities, and give them access to the sort of information on costs, prices and margins that are needed for making informed commercial and financial decisions.
 - d. Finally, in the **area of strategic planning**, the subprojects in question have no business plan and no clear conception of their strengths and market opportunities for developing new sources of income or increasing the profit margins on existing activities.
- 1.10 A number of visits to member MFIs belonging to the Rural Financial Network (RFR), together with the above-mentioned workshops, have confirmed that the small-scale producer associations of Ecuador are very much interested in improving these areas. However, while there are some opportunities for basic training, there are few options for direct technical assistance tailored to the specific needs of these associations.
- 1.11 **The need for investment.** After beginning as a small-scale production operation, producer associations that achieve a measure of success either independently or with the aid of government agencies or local NGOs, often find themselves in need of financing to expand their activities. This expansion usually includes some combination of the following: (i) increasing the volume or type of production or services; (ii) incorporating new technology or improvements at one or another stage of the production process; (iii) improving the quality, price, cost or profit margin on the products or services offered; and (iv) taking other action to attract new customers and/or increase sales or earnings from existing customers.

- 1.12 To achieve these objectives, cooperative subprojects must invest in both working capital and machinery and equipment. Specific examples of the sorts of investment that are neglected include bulking centers, processing plants, irrigation systems, advance financing of production or marketing costs for agricultural products, proactive participation in efforts to develop new value-added distribution systems, transfer of modern technology and development of sustainable marketing channels based on demand requirements. The informal nature of many associations and the above-mentioned institutional limitations, in particular, keep these associations from gaining access to the long-term financing available from the traditional financial sector and needed to invest in the expansion of their activities.
- 1.13 Moreover, as indicated earlier the majority of FMIs operating in the rural sector and virtually all SLAs prefer to focus their efforts on individual rural microenterprises, generally lack sufficient asset to offer resources in other production areas. However, a few major breakthroughs have now been achieved, and **seven MFIs belonging to the RFR have already granted loans for cooperative subprojects in rural areas of Ecuador.**

D. The Bank's strategy and experience with support programs for microenterprises and small farmers

1. Background to the Social Entrepreneurship Program in Ecuador

- 1.14 The Bank's strategy for Ecuador includes support for sustainable regional development and poverty reduction. These strategic objectives are delineated in the Bank's country paper which also places priority on developing those agricultural sectors that produce nontraditional and handicraft products for export.⁶ This aspect of the Bank's strategy for Ecuador is spelled out in the Social Entrepreneurship Program (SEP) which provides a framework for supporting those sectors. In recent years, the PES has provided support for agricultural production and marketing projects, modernization of irrigation systems, village banks, and technical assistance and lending programs for indigenous farmers.

2. Strategy and Policy of the Social Entrepreneurship Program

- 1.15 **Strategy.** Under the SEP's framework policies, and in the Bank's Country Paper and discussions with rural and indigenous organizations, the SEP seeks to encourage initiatives that (i) propose innovations and value-added procedures that benefit the target group; (ii) support activities in agricultural production, marketing, processing or investment that are financially sustainable and capable of meeting their financial obligations; (iii) take place in rural areas and involve indigenous or campesino communities; (iv) have a clear-cut business focus based on market demand; and (v) generate or strengthen local employment opportunities for indigenous or campesino groups living in rural areas.

⁶ Ecuador: Country Paper. Regional Operations Department. 19 April 2001.

- 1.16 **Policy.** The program proposed here is of the type defined as a project or umbrella facility under the Bank's Social Entrepreneurship Policy (GP-75-9). However, the umbrella type described under that policy specifies that the approval process for individual operations will be carried out by the Bank's Country Office, whereas in the present case the Bank is providing a set of selection requirements and allowing the program's executing agency to manage the approval process. This exception is justified by the economy of scale achieved through decentralized management of the operation, and is consistent with the philosophy of the umbrella.
- 1.17 **Complementarity with other activities of the Bank.** At the same time, the Bank is preparing an operation entitled "Deepening of Financial Services in Rural Areas" (loan EC-0213) for the transfer of financial technology to both registered and unregistered intermediaries wishing to expand into the rural sector. This loan operation —the Profile I Summary of which was approved recently—includes technical cooperation activities that will help to expand financial services in rural areas of Ecuador.
- 1.18 Loan EC-0213 and the program proposed here complement one another in the following ways: (i) Loan EC-0213 is aimed at all potential borrowers requiring rural financing and does not include development of specific mechanisms better able to meet the needs of rural associations formed by indigenous and campesino groups, as is the case with the present program; (ii) Loan EC-0213 will assist entities that have yet to extend financial services to rural areas, whereas the present program will work only with entities that are already actively engaged in rural financing; (iii) Loan EC-0213 will provide technical cooperation for financial intermediaries themselves, whereas this program will extend technical cooperation to associations of rural producers only and not to the intermediary lenders. It is worth noting as well that as a result of this complementarity, the experience and lessons learned here will be available for incorporation into loan operation EC-0213, which will be implemented after the present program.

3. Advantages and innovations included in the Support Mechanism for Rural Cooperatives

- 1.19 **Pre-selection of subprojects.** Drawing from applications submitted directly to the Bank, plus the 46 subprojects identified through the organizations participating in the two workshops, the Bank has prepared a representative sample of 22 subprojects requiring US\$1.1 million in credit resources to provide selected rural cooperatives with working capital and funds for investment in fixed assets (see technical files). The funds provided under these subprojects call for a wide variety of investments, for example, the construction of bulking or storage facilities, or the purchase of machinery for cleaning and classification of grain. However, in all cases a preinvestment study will be required to determine the commercial, socioeconomic and financial viability of the proposed investment. A large number of these pre-selected subprojects will provide nonagricultural employment in rural areas.

- 1.20 **Satisfying unmet demand for financing of cooperative subprojects.** While Ecuador has a number of private institutions that lend to microenterprises, there are few microfinance entities offering substantially larger loans such as those required under this program. Nor can demand of this magnitude be met by the public lending programs or the lines of credit available from the Corporación Financiera Nacional (CFN). **In the first place**, the CFN lines of credit reserved for microenterprises are limited to a maximum of US\$10,000 per project, which is far short of the amount required for investing in a production project. **Secondly**, the CFN lines of credit reserved for small and medium-sized enterprises (SMEs) come with guarantee requirements that are difficult for them to meet, and are channeled through registered financial institutions subject to regulation. **Thirdly**, the option of seeking to attract resources from the public is of course out of the question for NGOs, and in the next few years will also be unavailable to credit unions with less than US\$200,000 in capital. **Finally**, none of these types of financing would include resources funds for feasibility studies enabling borrowers to determine the viability of their investments. The technical files list the characteristics of different sources of financing for RCEs, along with the limitations on the use of these sources to finance subprojects to be carried out by rural cooperatives.
- 1.21 **Subprojects in sectors with the potential to devise best practices.** Opportunities for employment in the formal sector of Ecuador's rural economy are increasingly rare, and at the same time both the indigenous and campesino communities have a long tradition of working cooperatively. Therefore, the creation of a Social Entrepreneurship Program (SEP) that would encourage microfinance entities to fund this type of cooperative effort should make it possible to formulate best practices with respect to institutional design and credit technology, and help the Bank to incorporate these practices into its future large-scale lending operations in the rural sector.
- 1.22 **Economies of scale.** The transaction costs involved in supporting rural cooperatives could be reduced through the use of a decentralized mechanism capable of carrying out these tasks without detracting from the quality of the projects that are approved. The economies of scale inherent in this program can be seen above all in the consolidated handling a large number of small technical cooperations for cooperative enterprises, which would otherwise be impossible to administer.

E. The Bank's role

- 1.23 In order to meet the need for pre-investment studies and financing of cooperative subprojects of the type described above, it is proposed that a **Support Mechanism for Cooperative Enterprises in Rural Ecuador** be established, under which the Bank will make resources available for this purpose and to assist low-income groups in rural areas. The proposed program will grant reimbursable financing and technical-cooperation funding to rural groups including cooperatives, producer associations of microentrepreneurs, associative enterprises, and other organizations made up of small producers operating in rural areas.

F. Origin of the operation

- 1.24 To make certain that the program is administered by an executing agency of proven capabilities, the Project Team analyzed various entities and programs that could fill the role of executing agency. Given their experience in rural financing of medium-sized cooperative projects, the Project team narrowed the field to three entities or programs: (i) the FONLOCAL program, which is managed jointly by the Ministry of Social Welfare (MBS) and the IICA (Inter-American Institute for Cooperation on Agriculture); (ii) the PRODEPINE program, which forms part of a rural development program supported by the World Bank and the IFAD;⁷ and (iii) the Rural Financial Network.
- 1.25 After analyzing these three options, the Project Team decided to work with the Rural Financial Network which, although not a direct financial intermediation entity itself, has a great deal more firsthand experience with private sector entities—particularly NGOs and SLAs—that offer lending services in rural areas, and that in several cases are already financing cooperative subprojects. In the end, this experience factor was deemed crucial to the success of the program. The RFR is currently working on training and technical assistance programs in the area of microfinance and rural credit operations.

G. Statement of nonobjection

- 1.26 The Bank's statement of nonobjection was issued by the Government of Ecuador on 11 October 2002. Under its constitution, the RFR is legally empowered to receive loans and technical cooperation resources from Ecuadorian and international institutions, as well as to lend resources to other national institutions.

II. THE PROGRAM

A. Objectives

- 2.1 The **overall objective** of this program is to help improve the socioeconomic conditions of low-income families living in rural Ecuador.
- 2.2 Its **specific objectives** are to: (i) establish an effective and sustainable mechanism for identification, selection, approval and supervision of preinvestment and investment in cooperative subprojects involving agricultural production in rural Ecuador; (ii) enable at least 50 producer associations to determine the commercial viability and improve the management of their projects; (iii) help 35 rural producer associations increase income and develop initiatives to obtain funding for expansion of their activities; (iv) provide institutional strengthening for

⁷ A comparative analysis of the three candidate executing agencies is available from the Bank's Technical Files.

participating producer associations so that in future they will have access to local financing; and (v) achieve the critical mass of subprojects necessary to permit the spread of lessons learned in Ecuador about the financing and management of rural production activities.

B. The program's beneficiaries and strategy for supporting them

- 2.3 The beneficiaries of this program are the families of some 2,000 small-scale and low-income farmers in indigenous or campesino communities who belong to a rural association such as a cooperative, producer association or other associative enterprise, and microentrepreneurs belonging to organizations with cooperative production activities in agriculture and nonagricultural sectors. These families currently have a standard of living which includes several unmet basic needs and per capita average annual income of around US\$600. The program will also benefit rural cooperatives that are experienced in their area of specialization, but whose limiting factors include weak linkage to customers and lack of access to financing and appropriate technology. The subprojects that receive financing under the program will meet all the criteria and rules set out in the SEP policy approved by the Bank in 1998 (GP-75-9).

C. Components

- 2.4 The program consists of a reimbursable financing component plus a nonreimbursable technical-cooperation component, and will have a total budget of US\$1,935,000. The Bank is allocating US\$1,650,000 to the program, to be drawn from the net income of the Fund for Special Operations (FSO). In addition, the RFR and participating rural credit entities will provide US\$285,000 as local counterpart funding under the program.

1. Reimbursable financing (Bank US\$1,200,000, Counterpart US\$180,000)

- 2.5 The reimbursable financing component is intended to finance activities under production subprojects proposed by cooperatives enterprises in rural areas, through loans granted to these groups by no less than four nor more than eight rural credit entities (RCEs), mainly NGOs and SLAs. The program will include loans from the RFR to the RCEs for onlending in the form of subloans to at least 35 subprojects submitted by producer associations. Average disbursement per subproject will total US\$34,300.
- 2.6 The technical files contain the Operating Regulations that will govern loans granted by the RFR to the rural credit entities, including: (i) eligibility requirements for RCEs; (ii) selection of participating RCEs from a list of eligible entities; (iii) terms and conditions of loans granted to RCEs; (iv) processing and supervision of loans to RCEs; and (v) the role of the agent bank that will administer funds in trust.

2.7 The technical files also contain the Credit Regulations that will govern financing provided by the **RCEs to participating cooperatives**. The highlights of these regulations can be summarized as follows:

- a. The general eligibility requirements for cooperatives seeking resources for their subprojects under the reimbursable financing component include: (i) the applicant must have been in existence as an association for at least one year; (ii) it must have at least two years' experience in the relevant production area or services; (iii) the subproject must benefit at least 10 families; (iv) it must be backed by at least one local organization; and (v) the request must be accompanied by a feasibility study and completed application form.
- b. The eligible **categories** for which financing may be provided under the program include working capital and fixed assets for production activities, marketing, processing and investment, and loans may only be granted for sustainable subprojects that are submitted by an association and that are carried out in rural areas, include indigenous or campesino communities and have a business focus.
- c. The **activities** to be financed must be intended primarily to improve links with customers and markets, either to attract new customers or to increase sales and profits earned from existing clients. For this reason, the association is required to have a clear definition of its target markets.
- d. **Loans** for such cooperative subprojects will be for a minimum amount of US\$10,000 and a maximum of US\$60,000. The period of the loan may not exceed five years, and the borrower association will be required to make a counterpart contribution equivalent to at least 30% of the total amount of the loan. The RCE will be free to set the rate of interest charged on subproject loans as it sees fit, provided it does not exceed the maximum rate for Ecuador's financial system published by the Central Bank of Ecuador (BCE). As of July 30, 2002, this rate was set at 20.6%. The technical files show projected rates of interest for both RFR loans to the rural credit entities, and loans granted by the latter to associations for their subprojects, under different scenarios.

2. Technical cooperation (Bank US\$450,000, Counterpart US\$105,000)

2.8 The technical-cooperation component is designed to accomplish two fundamental tasks, namely: (i) to identify those subprojects with the potential to qualify for financing and expansion of activities; and (ii) to provide institutional strengthening for rural associations receiving Reimbursable Funding, and for the program's executing agency.

a. Subcomponent for identification of subprojects (preinvestment)

2.9 A total of US\$100,000 in technical-cooperation funding will be used to carry out some 50 preinvestment studies on subprojects that qualify for participation. These

studies are intended to help associations define their markets and financing needs more closely, and will be carried out by consultants listed in the roster of rural consultants and experts maintained by the RFR. On average, each study will require one consultant-month to complete. The maximum amount disbursed by the RFR per project will be US\$2,000. Each study will require a local counterpart contribution equivalent to at least 20% of its total cost (for example, US\$200 for a study costing US\$1,000).

- 2.10 Preinvestment studies may include: (i) feasibility study; (ii) business plan; (iii) management system; (iv) financial administration; (v) strategic planning; (vi) operational recommendations in the four areas mentioned; (vii) investment budget (working capital and fixed assets); (viii) cost projections, sales and financing requirement; and (ix) loan application in the format established by the RFR and rural credit entities.

b. Institutional strengthening subcomponent (simultaneous with investments)

(i) Institutional strengthening for cooperative enterprises

- 2.11 The sum of US\$250,000 will be used to fund a minimum of 35 technical cooperation projects for cooperatives receiving loans under the reimbursable financing component. Total expenditures under each TC will be up to a maximum of 20% of the amount of reimbursable financing received, an average of US\$7,142 per subproject. These resources will be disbursed through the cooperative enterprise for payment to experts hired from the roster of rural consultants, and will require a counterpart contribution from the cooperative equal to 10% of the total charge for the consultancy. To ensure the sustainability of the program and successful continuation of subprojects upon completion of the program, the technical-cooperation funding will be repayable to the RFR over a maximum of five years, providing the Network with funds for strengthening future subprojects.
- 2.12 This fund will finance the following technical assistance activities for subprojects: (i) advice on marketing strategy; (ii) technical assistance on investing and procurement; (iii) management consultancy services for producer associations; (iv) monitoring and correction of subproject plan; (v) advice on setting up accounting and financial management systems capable of tracking the association's economic activities and providing access to other sources of financing; (vi) help in drawing up a constitution and formalizing the legal status of the association; and (vii) technical assistance on improving quality, sales, productivity and rate of return.

(ii) Institutional strengthening for the program

- 2.13 Finally, resources totaling US\$50,000 have been earmarked for the program's start-up activities, particularly advertising, drawing up rules and procedures, and

initial screening of subprojects and applications from the RCEs. The program includes allocation of a further US\$50,000 for evaluations, audits, managing the roster of rural consultants and contingencies.

D. Costs and financing

- 2.14 The program will have a total cost of US\$1,935,000, of which US\$1,200,000 will constitute the reimbursable financing component, US\$450,000 will be allotted for technical cooperation, and US\$285,000 represents local counterpart. The Bank's Loan totaling US\$1,200,000 will be amortized over 15 years, with a grace period of 5 years. The grace period applies to amortization and capital.

General Budget (US\$)	Bank	Local	Total
Component 1: Reimbursable Financing	1,200,000	180,000	1,380,000
Component 2: Technical Cooperation	450,000	105,000	555,000
a) Fund for identifying subprojects	100,000	25,000	125,000
b) Fund for strengthening of subprojects and the program	350,000	80,000	430,000
Total	1,650,000	285,000	1,935,000

- 2.15 The loan will be denominated in United States dollars, and the Bank's rate of interest to the RFR will be 2% per annum. The rate of interest charged by the RFR to the RCEs will be the average 90-day deposit rate paid by Ecuador's financial sector, or the TRP reference rate published by the BCE, plus a commission of 4 percentage points to cover the operating costs incurred in executing the reimbursable financing. As of July 30, 2002, the TRP was 5.4%, so that the rate charged by the RFR to the rural credit entities would be 9.4%, payable in United States dollars. Beginning in the second year of the program, the RFR may lower its commission for operating costs if these expenses prove to be less than 4% on its average overall portfolio. The interest rate charge between the RFR and RCEs will be adjusted semiannually. The RFR will contribute 2% of the interest payments made by the RCEs in a reserve fund to cover uncollectibles (see the technical files for financial projections vis-à-vis reimbursable financing).

III. EXECUTING AGENCY AND INTERMEDIARY ENTITIES

A. Status, origin and objectives of the executing agency

- 3.1 The Rural Financial Network (RFR) is a non-profit civil corporation constituted under private law on June 16, 2000. Its most important objectives include: (i) mobilizing and channeling financial and non-financial resources to juridical and physical persons or community organizations for use in production activities; (ii) developing viable financial alternatives for the marginalized urban and rural sectors; (iii) conducting research intended to provide members of the Network with

the elements necessary to satisfy unmet needs of the marginalized urban and rural sectors; (iv) forming strategic alliances with other institutions, juridical persons or community organizations to create synergies and develop new agricultural production processes; and (v) reinforcing the operations of rural financing agents.

B. Organizational structure of the executing agency

- 3.2 The RFR's organizational structure is headed by its General Assembly made up of representatives from the 27 leading microfinance institutions of Ecuador, which form the membership of the Rural Financial Network. The Assembly meets in formal session once a year and delegates responsibility for administration of the Network to a Board of Directors consisting of seven members with the right to vote. This Board plays a leadership role, determining overall directions, setting policy and supervising the activities and development of the institution. The Board of Directors, in turn, delegates management of the institution in an Executive Director who is responsible for day-to-day supervision of the various project portfolios and activities of the Network.

C. Activities of the executing agency

- 3.3 The RFR works in three main areas: (i) Training, Studies and Projects; (ii) Regulatory Oversight and Self-regulation; and (iii) Development of Financial Markets. Within the overall administration of the RFR, the Executive Director will be responsible for execution of the program, which falls within the area of Development of Financial Markets.
- 3.4 The activities of the Network are designed to accomplish the objectives laid down for its three areas of activity. Under **Training and Projects**, the RFR, in conjunction with or under contract to Ecuadorian universities and international bodies such as the SEEP (Small Enterprise Education Network), offers specialized courses on rural credit technologies, information systems and risk. In this area as well the RFR provides consulting services for the evaluation of rural credit programs. Recently, the Network was invited to participate in an institutional strengthening program for the microfinance sector known as SALTO, which is being financed by USAID. In the area of **Regulatory Oversight and Self-regulation** the RFR is working with various national entities and international agencies such as Development International DeJardins (DID) to establish more effective means for overseeing MFIs. And finally, under **Development of Financial Markets**, the Network is working with its 27 members to computerize financial information and microfinance data in particular, as a means of promoting the sector and achieving common goals such as obtaining financing to existing loan portfolios and technical assistance for strengthening of the sector's institutions, and creating a higher profile in the country's economic and political circles. The technical files list information on SLAs and NGOs that are members of the Rural Financial Network.

D. Financial status of the executing agency

- 3.5 The RFR obtains its funding through the services it offers, consultancies and monthly membership fees received from its members. At present the RFR has a net worth of US\$3,200 on assets totaling US\$35,000. In 2002 it has earned a total of US\$26,000, showing a profit of US\$3,200. The Network's 2001 financial statements and balance sheet have been duly audited, and it has been very successful in attracting the best rural credit institutions in Ecuador. The technical files illustrate the strengths of the RFR members that may be participating in the program, including each entity's total amount of lending, number of clients, geographical coverage and overdue loan portfolio.
- 3.6 The balance sheets for the last two years, and the projections made for the 2002 year, are compared in the technical files. It should be noted that the RFR is not, properly speaking, a second-tier entity, nor will it act in that capacity in the present operation. Thus, following the first disbursement of the reimbursable financing, the Network may not request successive disbursements until it can demonstrate that the funds received in previous disbursements have been placed with an eligible RCE with which the RFR has signed a loan agreement. The technical files include a list of the seven RCEs that have been identified to date as eligible to participate in the program. The technical files also contain the requirements that all RCEs must meet if they wish to participate.

E. Comparative advantages of selecting the RFR as executing agency

- 3.7 The advantages of having the RFR act as executing agency for the program include the following: (i) its wealth of firsthand knowledge of the performance, circumstances and management capacity of the great majority of the Ecuadorian RCEs belonging to the Network; (ii) its experience in carrying out projects that require monitoring of financial indicators as a measure of the performance of Ecuadorian RCEs; (iii) its reputation among Ecuador's RCEs who see the RFR as a serious organization and a neutral party among entities with different methods and international partners; (iv) its experience managing rural microfinance projects in cooperation with international partners such as SEEP and USAID.
- 3.8 Another advantage is that the Network has an online system in place, with modules set up to transmit and process the data on financial information provided by members, and over which it can continuously update its financial information for self-regulation of the NGOs. The majority of this information is available on the Network's Web page at www.rfr.org.ec. The RFR is also widely experienced in the handling and validation of reports on the attainment of financial performance indicators, including cash flow and portfolio reports from a large variety of both registered and unregistered financial institutions, including SLAs, NGOs and banks that are active in the rural credit sector.

F. Rural credit entities (RCEs)

- 3.9 The reimbursable financing resources will be loaned to cooperative associations by rural credit entities, with a minimum of four and maximum of eight such RCEs participating in the program. The Project Team has identified seven RCEs that belong to the Rural Financial Network and are already granting loans to rural associations. Based on the performance of their loan portfolios, their level of activity in rural settings, and the extent to which they have demonstrated financial and economic sustainability, participating RCEs will be selected by the RFR using a competitive system in which points will be assigned to applicant RCEs as set forth in the Operating Regulations (technical files).
- 3.10 A public and open invitation will be announced in order to encourage participation by any rural credit entity that meets the eligibility requirements, whether or not they belong to the RFR. Once the rural credit entities have been selected, the RFR will be responsible for signing loan contracts with each RCE that has submitted a proposal for the financing of a subproject that meets the requirements of this program. The eligibility requirements for participation by RCEs are consistent with those that microfinance SNGOs must meet to qualify for loans under the Bank's Global Microenterprise Credit Program.

G. Justification for the choice of the RFR as executing agency for the reimbursable financing

- 3.11 The consolidation of onlending to the RCEs in the Rural Financial Network will make for more efficient program execution. If the Bank had to sign loan contracts with each of the RCEs, it is estimated that this together with processing of requests for disbursements, communications and amortization repayments would mean incurring four to eight times as much in transaction costs. Also, consolidating the financing of RCE subprojects through the RFR give the Network a further stake in the program.
- 3.12 It must be remembered as well that one of the program's objectives is to create a local and viable mechanism for the financing of subprojects related to production. Were the Bank to maintain a separate relationship with a number of RCEs for the same type of subproject, it would be missing an opportunity to help lay the groundwork for a consolidated mechanism for financing such subprojects.
- 3.13 As noted, the RFR is not a second-tier entity, nor does it have the equity to provide the Bank with a guarantee for the amount of reimbursable financing involved in the program. For this reason, the program includes transferring the entire credit risk to the participating RCEs, numbering at least four and as many as eight entities. This transfer of credit risk to the rural credit entities will be carried out by means of loan agreements as explained in the following section on execution.

IV. EXECUTION OF THE PROGRAM

A. Responsibility for Program Execution

- 4.1 **Project Executing Unit.** The Rural Financial Network will establish a Project Executing Unit (PEU) consisting of a program manager appointed by the RFR's board of directors, one specialist in rural credit operations, one financial accounting coordinator, and one administrative assistant. The PEU will be responsible for execution of the program; identification, selection and supervision of the RCEs; and technical oversight of the subprojects. The PEU will also oversee administration of resources under the nonreimbursable technical-cooperation funding, and must comply with the terms and conditions laid down in Annex I, Plan of Operations.
- 4.2 **Credit Exposure.** The RFR's exposure with respect to the Bank's Loan will be covered by loan agreements signed between the Network and the RCEs for the full amount of the RFR's indebtedness to the Bank. To this end, and as a condition for authorization of each disbursement from the reimbursable financing, the RFR must present to the Bank loan agreements duly signed with the RCEs. This condition will be in effect from the first disbursement to the revolving fund, equivalent to 20% of the reimbursable financing. These agreements will contain a provision for entry into force on the date that the Bank makes disbursements to the RFR, and will be for a minimum of US\$150,000 and a maximum of US\$300,000 per RCE. The regulations for loan agreements between the RFR and RCEs appear in the technical files.
- 4.3 Each of the participating RCEs assumes the credit risk inherent in the loans it grants to subprojects, so that any problems that arise with the latter will have no repercussions on payments to the RFR. Each RCE will approve the loans to subprojects with the knowledge that it is assuming a debt directly with the RFR. To guarantee the total transfer of the credit risk under the program to participating RCEs, all disbursements from the Bank's reimbursable financing, and interest and capital repayments by RCEs to the RFR, will be made into a trust account administered by a major Ecuadorian bank, in accordance with the terms and conditions described in the technical files.

B. Execution and administration of the program

1. Reimbursable financing for subprojects carried out by associations

- 4.4 **Sequence of activities.** The subproject financing stage of the program will include the following activities: (i) workshops given by the RFR to provide information on the program, to which RCEs from all areas (highlands, coast and southern region) will be invited; (ii) promotional events carried out by the RCEs under the reimbursable financing and technical-cooperation components, to which rural producer associations and cooperatives in each RCE's area will be invited; (iii) applications for financing submitted to the RCEs by associations whose pre-

investment studies have been completed; (iv) independent subproject risk evaluations carried out by RCEs in conjunction with the relevant association, for submission to the RFR; (v) preparation of pre-approved subproject application packages by RCEs, and submission of these packages to the RFR for financing; and (vi) financing granted to subprojects, and execution and repayments monitored by the RCEs.

2. Technical cooperation

- 4.5 **Sequence of activities.** In executing the technical-cooperation component, the RFR: (i) put into operation the roster of rural development consultants and experts eligible to participate in the program; (ii) advertise the technical cooperation component among producer associations and cooperatives; (iii) receive applications for preinvestment studies submitted by associations and cooperatives; (iv) determine which subprojects meet the program's eligibility requirements; and (v) assist producer associations and cooperatives in specifying the contents of preinvestment studies, evaluating the qualifications of specialized consultants, and signing consulting contracts between the cooperative and a consultant selected from the roster of rural consultants and experts.
- 4.6 The first subcomponent of the technical-cooperation component will be carried out in a manner completely independent of the reimbursable financing component whereas the second technical-cooperation subcomponent will be executed in parallel with the reimbursable financing. The RFR will make payments to the consultants hired through the producer or cooperative associations in order that the latter may form a direct relationship with the selected consultants, monitoring their performance and verifying compliance with objectives and agreed activities.
- 4.7 **Outreach for the technical cooperation.** The RFR will use three specific means to disseminate the technical cooperation among rural associations and cooperatives, including: (i) a direct invitation from the RFR for its 27 members and other major stakeholders in the microfinance and rural credit sector to identify subprojects in their region and report them to the Network; (ii) a national call for proposals from development agencies, indigenous networks and NGOs with which the Bank maintains permanent contact; and (iii) three workshops specifically targeting representatives of grassroots organizations, indigenous associations and organized groups of small farmers (producer associations), in which the objectives and mechanisms adopted by the program will be explained.
- 4.8 **Subcomponent for identification of subprojects (preinvestment).** Selection of the 50 cooperative associations that are to receive consulting services under the program will be based on the criteria set out in the Plan of Operations. In order to qualify for a preinvestment study which will be carried out by an approved consultant, a subproject must meet the following eligibility requirements: (i) several members of the association must have been carrying out the production activity in question for at least two years on a small-scale, experimental basis; (ii) a group of

- 10 or more small producers or entrepreneurs must be committed to the subproject; (iii) the subproject must include an element of innovation or diversification compared to traditional activities in the area; and (iv) it must meet social and environmental eligibility requirements.
- 4.9 In the case of subprojects to be carried out in areas of the country with a high concentration of indigenous population, the end-borrowers or RCEs will also be required to demonstrate their experience and/or capacity to work with these groups, using appropriate sociocultural methods and personnel able to operate in these areas.
- 4.10 When the respective invitations have been issued, the process of selecting the subprojects to be financed will begin. Each project must be identified with a specific intermediary entity or RCE and this requirement will be explained in the workshops and calls for proposals. The RFR will lay out these possibilities in the workshops and letters of invitation sent to potential participants. Also, those proposals that show potential, but suffer from weaknesses in their presentation and do not yet qualify for reimbursable financing, may apply for technical-cooperation funding to carry out feasibility or preinvestment studies if they meet the respective eligibility criteria.
- 4.11 **Institutional strengthening subcomponent.** For the first activity under this subcomponent, **institutional strengthening for the cooperative associations**, technical-cooperation funding may only be granted for subprojects that have received reimbursable financing through a rural credit entity, and the proceeds may not be used for current expenses of the end-borrower such as payment of wages, rent or other related expenditures. Budgeted items for the acquisition of fixed assets such as equipment and machinery may not be financed under the technical-cooperation component.
- 4.12 For the second activity, **institutional strengthening for the program**, a total of US\$50,000 has been allocated for the program's start-up costs. These resources will finance the first 18 months' salaries of a specialist in rural credit cooperatives and the technical coordinator for the program who will: (i) conduct the first assessment of the initial subprojects and establish the operating mechanisms; (ii) carry out the three activities aimed at advertising and promoting the program; and (iii) prepare and administer the initial start-up procedures including organization of the process for analysis and initial documentation of the program. Additional resources have been allocated under the technical cooperation as follows: US\$5,000 for equipment and materials; US\$25,000 for evaluations and audits; US\$10,000 for compiling and maintaining the roster of consultants; and US\$10,000 for contingencies.

C. Execution period and disbursement schedule

- 4.13 The program will be executed over a period of 36 months, with a disbursement period of 42 months. The Bank will disburse the program's resources on the basis

of the financial and operating needs of subproject packages that have been approved and submitted to the Bank by the RFR. The first technical-cooperation subcomponent will be executed independently, while the second will be carried out *pari-passu* with activities under the reimbursable financing component.

D. Monitoring and oversight

- 4.14 **Monitoring.** During execution of the subprojects, the RFR must: (i) verify compliance with the goals and objectives of the subprojects, and include an indication of the level of compliance in the semiannual progress reports to be submitted to the Bank; (ii) ensure that the resources provided are being invested in the activities specified in the subprojects that have been approved, and only in those projects; (iii) ensure that the procurement of goods and services under the program is carried out using competition procedures that do not limit participation by bidders from member countries of the Bank; (iv) ensure that the goods and services used in the subprojects come exclusively from the Bank's member countries; and (v) ensure that each subproject is complying with the terms and conditions of its loan agreement.
- 4.15 **Oversight.** The agreements signed between the RFR and the intermediary entities must specifically empower the Bank to conduct oversight activities and supervise the subprojects and the RCEs through officials of the COF/CEC or other authorized offices. The semiannual reports will be reviewed by a trilateral program oversight committee which will include a delegate from the COF/CEC, a representative of the RFR elected by its board of directors, and a representative elected from among participating RCEs. This trilateral committee may issue recommendations for improving management of the program.

E. Reports

- 4.16 Beginning in the year of the first disbursement under the program and within 60 days following the close of each six-month period, the Rural Financial Network will submit semiannual progress reports to the Bank containing financial information and a description of its activities. These reports will include at least the following: (i) information on the procedures carried out and the subprojects chosen in the selection process; (ii) description and financial information on the subprojects being carried out, in a form approved in advance by the Bank; (iii) a report including the entities invited to participate in the program and indicating how representative they are of the sector; and (iv) information on the quality of the subloan portfolio. The last of these reports will be the final report on the program and must contain a summary of the results achieved based on its original objectives. The Bank will review the results and recommendations set out in these reports. In the event that significant deficiencies are detected during execution of the program, the Bank will not authorize any further disbursements until the Rural Financial Network has taken the proper measures to correct them.

- 4.17 Throughout the execution period, and within 120 days following the close of each fiscal year, the RFR will submit its audited financial statements to the Bank. In addition, a financial report drawn up by independent authorities will be submitted within 90 days following the end of the last disbursement period for the nonreimbursable technical-cooperation funding, showing the manner in which the Bank's contribution was used.

F. Performance indicators

- 4.18 The performance indicators for the program will consist of: (i) the benchmarks of the program itself; and (ii) the achievement indicators for the individual subprojects.
- 4.19 **Program benchmarks.** Both the semiannual progress reports that the RFR submits to the Bank and the midterm evaluation of the program will include information for comparison with these benchmarks. The attainment of these benchmarks will represent a contract obligation of the RFR, in order for disbursements under the program to continue. In the event of a deviation of over 20% in the attainment of two or more of these benchmarks, the Bank will agree on the necessary corrective measures to be carried out by the RFR and may suspend disbursements.

Benchmarks (cumulative)	2003	2004	2005
TECHNICAL COOPERATION			
1. Preinvestment studies	15	30	50
2. Institutional strengthening for subprojects	10	22	35
3. Workshops for program outreach (Highlands and Coast)	2	2	2
REIMBURSABLE FINANCING			
Rural Financial Network			
1. Cumulative disbursements (\$)	300,000	725,000	1,200,000
2. Subprojects evaluated and completed	0	10	20
3. Quality of the loan portfolio: Overdue portfolio > 30 days	0%	2%	5%
Rural Credit Intermediaries			
1. Cooperative associations with reimbursable financing	10	22	35
2. Portfolio of loans to cooperative associations	345,000	834,000	1,380,000
3. Delinquent portfolio for subloans: portfolio > 30 days past due	0%	2%	5%
4. No. of families of small producers benefiting from subprojects	500	1,200	2,000

- 4.20 **Achievement indicators for individual subprojects.** These indicators will reflect program impact on the end-beneficiaries. The figures for individual subproject benchmarks will be proposed by the consultants that carry out the preinvestment studies. Subsequently, the RCEs will review and agree upon the proposed benchmarks when the cooperative associations receive reimbursable financing. The PEU will conduct an annual review of compliance with the indicators. In the event of a shortfall of more than 20% below the agreed benchmarks 1 through 3, the RFR may request a review of the technical assistance documentation accompanying the reimbursable financing.

Achievement indicators for cooperative associations	Formula for annual calculation of the association's performance	Annual review
1. Sales	Total and per association member	Year-to-year increase
2. Links to identified customers (formal sector, non-local or new clients)	$\frac{\text{Sales to identified customers}}{\text{Total sales}}$	Percentage
3. Return	$\frac{\text{Net income / sales}}{\text{Total and per association member}}$	Year-to-year increase
4. Income per association member	$\frac{\text{Cash flow}}{\text{Number of association members}}$	Total

G. Evaluations

- 4.21 Once 60% of the reimbursable financing has been disbursed, the Rural Financial Network will use technical-cooperation resources to hire an outside evaluator to carry out a midterm evaluation of the program. The appointment of this external evaluator will require the Bank's nonobjection. Among the main aspects to be

analyzed in the midterm evaluation are: (i) demand for credit resources, as reflected in the proposals received and assessed by the executing agency; (ii) executing agency compliance with the rules and procedures established for the program; (iii) how swiftly the program responded to demand; (iv) the quality of the Rural Financial Network's portfolio of loans to the intermediaries and the quality of intermediary portfolios of subloans to cooperative enterprises; (v) the social impact of the subprojects and their sustainability, as reflected in business development; and (vi) recommendations to both the Bank and the executing agency for improving program administration.

- 4.22 Once 100% of the reimbursable financing has been disbursed, the Bank will also hire independent evaluators to conduct a final evaluation of the program. Among other aspects, this final evaluation will include analysis of: (i) the efforts made to advertise the program; (ii) the results obtained from investments made by associations of small farmers and end users; (iii) the effectiveness and efficiency of the executing agency in managing the Bank's resources; and (iv) the lessons learned from the program that can be applied to other financial facilities of Social Entrepreneurship.

H. Special contractual conditions

- 4.23 For the first disbursement of the reimbursable financing, the Rural Financial Network must submit the following to the Bank: (i) loan agreements between the Rural Financial Network and at least two rural financing intermediaries for a minimum of US\$240,000, containing a clause calling for entry into force on the same date that the Bank makes its disbursement to the Network; (ii) the Operating Regulations and final Credit Regulations, together with evidence that they have been placed in effect; (iii) the business and investment plan; (iv) evidence that the executing agency has been established; (v) evidence that the rural credit entities applying to participate in the program meet the general eligibility requirements; (vi) the agreement signed between the Rural Financial Network and an Ecuadorian bank operating in rural areas which will administer project funds in trust according to the terms and conditions established in the technical files; and (vii) the scheduled activities for advertising the program among RCEs and cooperative associations.
- 4.24 Prior to the disbursement that will push reimbursable financing over the 20% mark, the Rural Financial Network will provide the Bank with: (i) evidence that all of the resources to be disbursed in advance have been delivered to the rural credit entities; and (ii) loan agreements signed between the Rural Financial Network and rural credit entities for a minimum amount equal to the requested disbursement, and containing the two clauses referred to under condition (i) in the preceding paragraph.
- 4.25 For the first disbursement under the first subcomponent of the technical-cooperation, the Rural Financial Network shall present to the Bank's satisfaction the updated roster of rural consultants and experts. And for the first disbursement

under the second subcomponent of the technical-cooperation component, the Rural Financial Network must present: (i) a work plan for execution of the technical-cooperation component of the program during its first months, which will include inter alia the following aspects: (a) performance goals for the first year of each activity; (b) number of feasibility studies to be funded; (c) goals in terms of the number of subprojects and end-borrowers; (d) mechanism for supervision and control of the activities carried out by the RCEs; and, (e) human, physical and financial resources allocated to each activity; (ii) evidence that the program coordinator has been appointed; and (iii) compilation of initial data on the ultimate beneficiaries of the loans awarded by the RCEs.

V. FEASIBILITY AND RISKS

A. Institutional feasibility

- 5.1 The institutional feasibility of the program is based on the selection of an executing agency that is well acquainted with the rural credit entities belonging to its network and will have a risk classification system to rely on for the RCEs which are not members of that network. Based on a comparative analysis of possible executing agencies in Ecuador, the Rural Financial Network is in the best position to create a sustainable mechanism for financing the subprojects of cooperative associations. Moreover, selection of the RFR will enable the Bank to employ as intermediaries the only organizations already channeling resources into Ecuador's agricultural production sector. In addition, it is worth noting that although the RFR will assume full responsibility for execution of the program, there is the further guarantee of loan agreements signed between the RFR and the RCEs and intended to reinforce institutional capacity by drawing on the experience and availability of the network's human resources, primarily in the areas of investment and rural financing.

B. Socioeconomic feasibility

- 5.2 The program is viable from a socioeconomic standpoint because it seeks to support sustainable economic development initiatives by building on the experience gained among indigenous groups and low-income campesino communities in rural areas of the country. These projects are expected to benefit more than 2,000 families of small farmers or microentrepreneurs in rural cooperative associations through increased production and improved marketing of their goods and services. By providing access to investments in production and commercial projects, together with the activities financed with the technical-cooperation funding, the program will make it possible for these families to boost the productivity of their operations and economic activities, increase the value-added content of their products, sell their products at better prices, and thereby augment their incomes.
- 5.3 At the same time, the program will strengthen the institutional capacity of the rural credit entities by facilitating expansion of their loan portfolios to rural producer

associations, and with the added advantage of partial financing of both feasibility and preinvestment studies for these subprojects. This is consistent with one of the Bank's primary objectives for Ecuador, which is to deepen the financial services available in rural areas.

C. Financial feasibility

- 5.4 The program creates incentives for maximizing the financial viability of the program itself and the subprojects it is designed to finance. The executing agency will assume the credit risk inherent in its loan from the Bank, which guarantees that it will make every possible effort to enforce rigorous procedures in the selection of participating RCEs. In order to meet its loan repayments to the Bank, the executing agency and the participating RCEs will have to ensure that the end-borrowers likewise repay their loans as required. The rural credit entities that were preselected for the program have for the most part been rated by internationally recognized rating agencies. This is no guarantee, but it does ensure that the selection of subprojects will be made carefully, following rigorous systems and procedures based on experience and years of operation by the RCEs.

D. Environmental and social aspects

- 5.5 At its meeting on 1 March 2002, the CESI approved the project outline for the program. The present document incorporates the CESI's recommendations for the execution of the program in general, and for the subprojects in particular. The program will promote investment in sustainable economic activities that have no adverse effect on the environment. The criteria used for selecting subprojects will include environmental feasibility requirements, and the analysis of proposed sub-projects will include a review of each one's environmental strategy.
- 5.6 In the selection and approval of subprojects for inclusion in the program, both the executing agency and the Bank's Country Office will ensure that the credit regulations of the RCEs include environmental criteria governing the eligibility of the productive activities to be financed. For subprojects involving agricultural production, the executing agency will ensure that end-borrowers receive technical assistance in sustainable production techniques. Where warranted, the resources of the parallel technical-cooperation funding for each subproject may be used to cover the cost of a system for monitoring environmental aspects of a given project. In addition, insofar as possible subprojects will include training activities for rural beneficiaries on making rational use of natural resources and enforcing labor and health standards in the economic units receiving the benefits of the program. The women of campesino and indigenous communities will make up a significant proportion of the program's beneficiaries. The methods used by the RCEs are designed to include procedures and offer services aimed at the meeting needs of this group. As well, the contents of training materials used in the program will be designed with women in mind.

E. Risks

- 5.7 This program establishes the means for transferring 100% of the credit risk to the RCEs, so that the main risk facing the project is the possibility that these entities may fail to select the best subprojects. The following measures have been taken to minimize this risk: (i) the RCEs will have a data base of subprojects which meet the eligibility requirements and therefore have a good record of performance over a period of at least two years; (ii) subprojects applying to the program will have an opportunity to obtain technical-cooperation resources with which to conduct feasibility studies that will help the RCEs determine the viability of the investment requested; and (iii) participating RCEs will be required to have prior experience lending to credit associations and cooperatives.
- 5.8 A second risk inherent in the program is the possibility that a conflict of interest might arise between the Rural Financial Network and the RCEs in which an RCE that is a member of the RFR falls behind in its payments and seeks special treatment from the Network. This risk is mitigated by the fact that there will be only four to eight RCEs participating in the program, making up a relatively small proportion of the total membership of the Rural Financial Network. The remaining members (numbering 27 as of July 2002) will wish to maintain the reputation of the Network, and will not permit one member to threaten its relationship with the Bank.

F. Justification

- 5.9 Many of the requests that the Bank receives from Ecuador are designed to achieve objectives similar to those of the SEP policy, such as inclusion of indigenous communities, financing of projects submitted by associations and promotion of sustainable development. Requests from these small organizations for SEP resources has outstripped the Bank's administrative capacity for financing them. Accordingly, the present program is justified in that it proposes consolidating a large number of small-scale technical-cooperation projects and subloans to cooperative enterprises into a single operation, reducing the high transactions costs that would be incurred if the Bank had to administer each project directly.
- 5.10 The program is also justified by the fact that it will: (i) provide support for the development of production and marketing projects to be carried out by small farmers in Ecuador; (ii) give low-income rural associations better access to sources of funding and investment in production, processing and value-added projects which are vital for improving productivity and competitiveness; (iii) establish a sustainable private-sector mechanism to strengthen the operations of a large number of rural cooperatives; and (iv) permit rural credit associations to develop best practices in the technology for lending to cooperative associations.

PLAN OF OPERATIONS
TECHNICAL COOPERATION FOR THE PROGRAM
SUPPORT MECHANISM FOR
COOPERATIVE ENTERPRISES IN RURAL ECUADOR
TC-0202032-EC
Social Entrepreneurship Program

I. BACKGROUND

- 1.1 The Rural Financial Network, acting through the program's executing agency, will administer nonreimbursable technical-cooperation resources amounting to US\$450,000.

II. OBJECTIVES

- 2.1 This technical cooperation will be carried out in parallel with the program's nonreimbursable financing component. Its objectives are to: (i) enable at least 50 producer associations to determine the commercial viability and improve the management of their projects; (ii) provide institutional strengthening for the initiatives of 35 rural producer associations, helping them to obtain financing for expansion of their activities; and (iii) help to create a sustainable mechanism to provide working capital, fixed assets and technical assistance for subprojects carried out by cooperative associations in rural areas.
- 2.2 The technical-cooperation component will provide resources for three essential activities: (i) identification of subprojects with the potential to qualify for financing and expansion of their activities; (ii) institutional strengthening for entities that have received reimbursable financing to carry out subprojects, in the form of a specialized technical assistance package including preinvestment studies and general investment support; and (iii) ensuring proper allocation and recovery of the program's resources.

III. ACTIVITIES

1. Identification and selection of subprojects

- 3.1 The program will finance preinvestment studies on production subprojects that benefit low-income groups and are capable of having a significant social and economic impact on the community or rural area in which they are located. The

- preinvestment studies will analyze the financial and economic viability of each subproject and devise a business plan for achieving its aims.
- 3.2 To obtain financing for preinvestment studies, subprojects must meet the following eligibility criteria: (i) the production activity in question must have been in operation for at least two years on a small-scale or experimental basis; (ii) a group of more than 10 small producers or entrepreneurs must be committed to the subproject; (iii) the subproject must include elements of innovation or diversification compared to traditional activities in the area; and (iv) it must meet social and environmental eligibility requirements.
- 3.3 The effort to identify subprojects will be carried out by the Project Executing Unit within the RFR, and will be divided into the following phases:
- a. Phase I: Final formulation of the basic criteria for selection and approval of preinvestment studies.
 - b. Phase II: Workshop on the preparation of preinvestment studies. This workshop will serve to promote the program as well by providing training for potential beneficiaries in the development of business plans and preinvestment studies.
 - c. Phase III: Drafting the preselection conditions and issuing a call for proposals for access to funds allocated for preinvestment studies.
 - d. Phase IV: Analysis and selection of the proposals that best match the basic and additional criteria devised by the PEU of the program.
 - e. Phase V: Disbursement of funds to the entities selected and assistance for representatives from subprojects in selecting consultants to carry out their feasibility and preinvestment studies.
- 3.4 A total of US\$100,000 in resources from the technical-cooperation funding will be used to carry out some 50 preinvestment studies for subprojects that qualify. These studies, which are intended to help subprojects determine their financing needs more precisely, will be prepared by consultants selected from the roster of rural specialists kept by the RFR. These studies will take an average of one consultant-month to complete, and have an estimated maximum cost of US\$2,500. The maximum sum that the RFR will disburse per project is US\$2,000, and each study will require a local counterpart contribution equivalent to at least 20% of the total cost for its preinvestment study (e.g. US\$200 for a study costing US\$1,000). The RFR will make payments directly to the consultant selected by the RCE from the roster of consultants accredited by the program.
- 3.5 Preinvestment studies will include: (i) feasibility study; (ii) business plan; (iii) management system; (iv) financial administration; (v) strategic planning; (vi) operational recommendations in the four areas mentioned; (vii) investment

budget (working capital and fixed assets); (viii) cost projections, sales and financing requirement; and (ix) loan application in the format established by the RFR and rural credit entities.

2. Institutional strengthening

a. Subproject strengthening

- 3.6 Based on study of the subprojects identified in the design stage of the program, it appears that all of the subprojects receiving reimbursable financing will require support under the institutional strengthening component to be financed with resources from the nonreimbursable technical-cooperation funding. Access to these institutional strengthening resources will be by means of a financing proposal having the following characteristics:
- a. Phase I: Associations of producers or rural entrepreneurs wishing to carry out subprojects must prepare a financing proposal that includes two components: (i) reimbursable financing; and (ii) nonreimbursable financing. This proposal with its two components must be submitted on the form that candidates will receive either from their RCE, or from the PEU created within the Rural Financial Network.
 - b. Phase II: Completed proposals must be submitted to the respective RCE. The latter will be responsible for conducting a financial analysis deciding whether or not to approve the subproject for reimbursable financing, using criteria established in the Credit Regulations. Upon approval of that component, the proposal will be sent to the PEU for analysis and evaluation for purposes of the nonreimbursable financing component.
 - c. Phase III: The PEU will evaluate the institutional strengthening component and make a final decision whether or not to approve it. If it sees fit, the PEU may suggest approving the activities of the nonreimbursable component, but including them in the reimbursable financing package.
- 3.7 The program allocates US\$240,000 for 35 technical-cooperation projects to assist associations that are successful in obtaining reimbursable financing. Total expenditures under each TC will be up to a maximum of 20% of the amount of reimbursable financing received, an average of US\$7,142 per subproject. These resources will be disbursed through the cooperative enterprise for payment to experts hired from the roster of rural consultants, and will require a counterpart contribution by the cooperative equal to 10% of the total charge for the consulting services. To ensure program sustainability and successful continuation of subprojects upon program completion, the technical-cooperation projects will be repayable to the RFR over a maximum of five years, providing the Network with funds for strengthening future subprojects.

- 3.8 This fund will finance the following technical assistance activities for 35 sub-projects: (i) advice on marketing strategy; (ii) technical assistance on investing and procurement; (iii) management consultancy services for producer associations; (iv) monitoring and correction of subproject plans; (v) advice on setting up accounting and financial management systems capable of tracking the association's economic activities and providing access to other sources of financing; (vi) help in drawing up a constitution and formalizing the legal status of the association; and (vii) technical assistance on improving quality, sales, productivity and rate of return.

b. Program strengthening

(i) Start-up and management

- 3.9 A total of US\$100,000 has been allocated for the program's start-up costs, particularly advertising, drawing up rules and procedures, initial screening of subprojects, and conducting a midterm evaluation to measure progress under the program and document lessons learned. The program also includes allocation of resources for evaluations and audits.
- 3.10 The RFR is expected to hire a consulting service specializing in rural lending and investments to evaluate the initial subprojects and thus establish the basic mechanism for the operation. In effect, this will organize the process to be used in analyzing the initial documentation submitted under the program. The RFR will then be responsible for maintaining and continuing these administrative mechanisms after the second year of the program. The RFR will be able to use interest earned through its onlending operation using the program's resources—and agreed to in advance—for this purpose.

(ii) Equipment and materials

- 3.11 The acquisition of equipment and teaching materials to be financed with resources from the proposed technical-cooperation funding will include the purchase of computer hardware for the staff of the PEU established within the RFR, plus the preparation, design and printing of training materials required by the RFR's technical experts.

(iii) Evaluation and audit

- 3.12 In order to ensure effective execution of the program, the Bank will use resources from the nonreimbursable technical-cooperation funding to hire the consultants necessary to evaluate and document the program. This evaluation will be carried out when either 50% of the funds making up the nonreimbursable contribution has been disbursed or 18 months have elapsed since the beginning of the execution period, whichever occurs first. The evaluation will include: (i) an institutional assessment of the RFR and RCEs; (ii) analysis of the subprojects to determine the

degree of progress in terms of trade expansion and increased competitiveness; (iii) measurement of the impact of training and technical assistance provided under the program on management, production and marketing of products; (iv) survey of a 5% sample of the rural *campesinos* and indigenous participants to measure the impact the program has had on the standard of living of their families; and (v) based on the foregoing assessments, the evaluator will make suggestions and recommendations for continuing the program as is, correcting certain aspects of its execution, or suspending the operation.

(iv) Consultant roster updating and management

- 3.13 The RFC will update and manage a roster of eligible consultants specializing in rural development. To this end, it will use the data bases of consultants who have provided training to rural organizations through technical assistance under rural projects such as the PROMSA or INCCA programs.

IV. SPECIAL CONTRACTUAL CONDITIONS

- 4.1 For the first disbursement of the technical-cooperation funding, the Rural Financial Network must present to the Bank's satisfaction: (i) the updated version of the roster of rural consultants and experts; and (ii) a work plan for execution of the program during its first months, which will include inter alia the following aspects: (a) performance goals for the first year of each activity; (b) number of feasibility studies to be funded; (c) goals in terms of the number of subprojects and end-borrowers; (d) mechanisms for supervision and control of the activities carried out by the RCEs; and, (e) human, physical and financial resources allocated to each activity; and (iii) evidence that the Program Coordinator has been appointed.
- 4.2 As a requirement for the second disbursement under the TC, the RFR must present to the Bank's satisfaction evidence that the RCEs have compiled the initial data on the end-borrowers who will benefit from the program.

V. COSTS AND FINANCING

- 5.1 The total amount of technical-cooperation funding provided is US\$450,000, as shown in the following table:

1. Subcomponent for subproject identification			
50 preinvestment studies (at an average of US\$2,500)	100,000	25,000	125,000
Subtotal (50 subprojects)	100,000	25,000	125,000
2. Subcomponent for institutional strengthening	350,000	80,000	430,000
a. Strengthening of cooperative enterprises			
1: TC package at US\$7,142 for 7 subprojects (example)	50,000	10,000	60,000
2: TC package at US\$7,142 for 7 subprojects (example)	50,000	10,000	60,000
3: TC package at US\$7,142 for 7 subprojects (example)	50,000	10,000	60,000

4: TC package at US\$7,142 for 7 subprojects (example)	50,000	10,000	60,000
5: TC package at US\$7,142 for 7 subprojects (example)	50,000	10,000	60,000
Subtotal (35 subprojects)	250,000	50,000	300,000
b. Program strengthening			
2. Start-up and implementation of the program			
Expert on rural credit for associations	28,000	10,000	38,000
Program Coordinator	22,000	10,000	32,000
3. Equipment and material RFR	5,000	10,000	15,000
4. Program evaluation and audits	25,000		25,000
5. Consultant roster updating and management	10,000		10,000
5. Contingencies	10,000		10,000
Subtotal Preinvestment, Implementation and Evaluation	100,000	30,000	130,000
Total Technical Cooperation	450,000	105,000	555,000

VI. EXECUTION OF THE PROJECT

- 6.1 The proposed technical-cooperation project will be carried out in parallel with the reimbursable financing for the proposed program that will be approved at the same time. The RFR will be responsible to the Bank for execution of the different components and activities of the technical-cooperation component.
- 6.2 The technical cooperation project will be carried out over a period of 36 months, with disbursement over 42 months. The Bank will establish a revolving fund using 10% of the total resources of the component.
- 6.3 The RFR will be responsible for procurement of the equipment and other goods required for the program. Procurement will be carried out in accordance with the procedures, rules and policies of the Bank.

VII. REPORTS

- 7.1 Starting in the fiscal year in which disbursements begin, the RFN will submit semiannual progress reports to the Bank within 60 days after the end of each six-month period. These reports will include at least the following: (i) information on the execution of all components under the technical-cooperation project (procurement, contracts and training given); (ii) accounting reports showing total costs on each activity carried out; (iii) report on the progress and results achieved, as measured by improvements in the income of rural producers vis-à-vis starting point; (iv) updated version of the operating plan for the next 12 months, including the respective timetable and budget; and (v) a report on the organizations invited to participate in the program and how representative they are of the sector. The last of these reports will constitute the Final Report on the program and must contain a summary of the results achieved based on its original objectives.

- 7.2 The Bank will review the results set out in these reports. In the event that significant deficiencies are detected in the execution of the program, the Bank will not authorize any further disbursements until the RFN has taken the proper measures to correct them.
- 7.3 Within 60 days after the last disbursement of the technical-cooperation funding, the RFR must present to the Bank a financial report prepared by a firm of independent auditors and showing the way in which the economic contribution made under the program was used.

SOCIAL ENTREPRENEURSHIP PROGRAM SUPPORT MECHANISM FOR RURAL COOPERATIVE ENTERPRISES

LOGICAL FRAMEWORK

Narrative Summary	Indicators	Means of Verification	Assumptions
End			
To help improve the socioeconomic conditions of low-income families living in rural Ecuador by financing production and marketing projects proposed by producer associations, cooperatives and community organizations.	<ul style="list-style-type: none"> An increase in production and commercial sales of goods and services of rural origin produced by beneficiaries in subprojects supported by the program. An increase in investments in viable production projects in rural areas of Ecuador. 	<ul style="list-style-type: none"> Final evaluation of the program Progress reports submitted by consultants hired by cooperative associations for professional strengthening. Progress reports from RCEs 	<ul style="list-style-type: none"> Ecuador's economy maintains a certain degree of stability. The rural investment opportunities identified by the consulting team remain viable.
Purpose			
To establish an effective and sustainable mechanism for identifying, selecting, approving and supervising preinvestment and investments in the production subprojects of cooperative enterprises in rural Ecuador.	<ul style="list-style-type: none"> As of the end of year 3, at least 50 feasibility and preinvestment studies conducted. At the end of year 3 of the program, 35 subprojects financed. At the end of year 3, at least 35 cooperative subprojects strengthened institutionally. At least four RCEs financing cooperative enterprises with a portfolio of at least US\$1.2 million with program resources. 	<ul style="list-style-type: none"> Reports submitted by the intermediary. Evaluation reports. Loan and technical-cooperation agreements being carried out. 	<ul style="list-style-type: none"> Demand for the resources provided by the program remains at the same level or higher. The mechanisms established under the program (Operation Regulations) are effective and recursive during the execution period.
Components and activities			
1. Financing and execution of subprojects <ul style="list-style-type: none"> Establish effective mechanism for financing investments in productive rural cooperative subprojects. 	<ul style="list-style-type: none"> At least 35 subprojects identified, selected and approved. 35 subprojects financed 35 subprojects completed and evaluated. 	<ul style="list-style-type: none"> Subproject profiles. Financing proposals and business plans. Financing and technical-cooperation agreements signed by the intermediary. 	<ul style="list-style-type: none"> The quality of the proposals received is satisfactory. The selection criteria and procedures live up to expectations.

Narrative Summary	Indicators	Means of Verification	Assumptions
<ul style="list-style-type: none"> Help increase revenues and develop the initiatives of 35 associations of rural producers that receive financing to expand their activities. <p>2. Technical cooperation</p> <ul style="list-style-type: none"> Allow at least 50 associations of producers to become aware of the feasibility of their projects and to improve their management thereof Strengthen the participating associations of producers allowing them access to local financing resources in the future Have a critical mass of subprojects in Ecuador to allow the dissemination of lessons learned in the financing and management of rural productive activities. 	<ul style="list-style-type: none"> 35 subprojects that have met their development objectives Past-due RFR portfolio (over 30 days) below 5%. At least four RCEs financing rural cooperative enterprises. 50 feasibility studies conducted for cooperative enterprises 35 subprojects strengthened that comply with the policies and criteria of the Social Entrepreneurship Program and that are located primarily in rural areas of the country Mechanism to support rural cooperative enterprises strengthened Lessons learned disseminated among the 27 members of the RFR. 	<ul style="list-style-type: none"> Reports submitted by the intermediary. Evaluation reports. Audits of the program. Field visits by the Bank. 	
Activities			
<p>Identification, selection and approval of subprojects</p> <ol style="list-style-type: none"> Creation of the Project Executing Unit. Final preparation of document containing procedures and Operating Regulations. Identify subprojects. Carry out preliminary analysis of subprojects. Preselect subprojects. Approve preselected subprojects. Prepare proposals on subprojects. Negotiate based on proposals. Obtain statement of nonobjection. Approve final proposals. Sign subproject agreements. 	<p>Reimbursable financing: US\$1,200,000 Technical cooperation: US\$450,000 Local counterpart funding: US\$285,000</p>	<ul style="list-style-type: none"> Narrative and financial reports from the intermediary. Evaluation reports. 	<ul style="list-style-type: none"> The mechanism for identification and selection of subprojects used by the executing agency is effective and able to attract viable proposals from the eligible entities. There is a supply of qualified consultants capable of carrying out the technical assistance and evaluation activities.

Narrative Summary	Indicators	Means of Verification	Assumptions
<p>Execution and evaluation of subprojects</p> <ol style="list-style-type: none"> 1. Grant approval showing compliance with prior conditions. 2. Place in operation monitoring systems, portfolio controls, etc. 3. Make disbursements. 4. Conduct inspection visits. 5. Submit semiannual progress reports. 6. Hire consultants and coordinate evaluations of subprojects. 			